AN OVERVIEW OF STATE BOND DEBT

Prepared by the Legislative Analyst

This section provides an overview of the state's current bond debt. It also discusses the impact that the bond measures on this ballot would, if approved, have on this debt level and the costs associated with paying them off.

Background

What Is Bond Financing? Bond financing is a type of long-term borrowing that the state uses to raise money to finance major capital outlay projects. The state gets money for these projects by selling bonds to investors. In exchange, the state agrees to repay this money, with interest.

Why Are Bonds Used? The money raised from selling bonds primarily pays for the purchase of property and construction of facilities—such as parks, prisons, schools, and colleges. The state uses bond financing mainly because these facilities provide services for many years and their large dollar costs can be difficult to pay for all at once. The use of bonds can allow such facilities to be put in place earlier than otherwise and/or enable the state to use available tax dollars for other purposes.

Types of Bonds. The bonds the state issues are generally tax exempt and fall into two main categories—general obligation bonds and revenue bonds.

- ***General obligation bonds*** require approval by a majority of California's voters and account for most of the bonds the state sells. The state's debt service payments on nearly 90 percent of these bonds come directly from the state's General Fund, which supports a wide variety of programs and is funded primarily from the state's personal and corporate income taxes and the sales tax. The remainder of the general obligation bonds (such as veterans' housing bonds) are self-supporting and, therefore, do not require General Fund support.
- ***Revenue bonds*** generally do not require voter approval and most are supported by revenues generated from the projects they finance, such as bridges. These also include lease revenue bonds, which are financed through General Fund lease payments made by state departments and agencies occupying the facilities. The state pays higher interest rates on these lease revenue bonds than it does on general obligation bonds, mainly because—unlike general obligation bonds—interest and principal payments on them are not guaranteed by the California Constitution. The state has used these lease revenue bonds to build higher education facilities, prisons, veterans' homes, and state offices.

What Are the Direct Costs of Bond Financing? The state's cost for using bonds depends primarily on their interest rates and the time period over which they are repaid. Most general obligation bonds currently being issued are paid off over a 30-year period. Assuming current tax-exempt interest rates for such bonds (about 5.25 percent), the cost of paying them off over 30 years is about $2 for each dollar borrowed—$1 for the dollar borrowed and $1 for interest. This cost, however, is spread over the entire 30-year period, so the cost after adjusting for inflation is less—about $1.25 for each $1 borrowed.

The State's Current Debt Situation

Amount of State Debt. As of July 2002, the state had about $28 billion of General Fund bond debt outstanding—about $22 billion of general obligation bonds and $6 billion of lease revenue bonds. Also, the state has not yet sold about $11 billion of authorized bonds, either because the projects involved have not yet been started or those in progress have not yet reached their major construction phase.

Debt Payments. We estimate that payments on the state's General Fund bond debt totaled about $2.9 billion in 2001–02. Debt service payments are expected to fall temporarily in 2002–03 and 2003–04 because of the deferral of certain bond payments during these two years to help deal with the General Fund's budget shortfall. Debt payments should increase to about $3.6 billion in 2004–05, as previously authorized but currently unsold bonds are marketed. Thereafter, outstanding bond debt would slowly decline absent additional authorizations. If all of the $18.6 billion in bonds on the November ballot are approved and eventually sold, annual debt service payments would rise to about $4.7 billion by 2007–08, before declining in subsequent years.

Debt Service Ratio. The level of debt payments for principal and interest stated as a percentage of state General Fund revenues is referred to as the state's debt service ratio. This ratio increased in the early 1990s and peaked at slightly over 5 percent in the middle of the decade. It has since declined and stood at 4.3 percent in 2001–02. Based on current bond authorizations, the ratio will remain near current levels through 2004–05 and slowly decline thereafter. If all of the $18.6 billion in bonds on this ballot are approved and eventually sold, the ratio would increase to about 4.9 percent in 2004–05 and decline thereafter.

Bond Propositions on This Ballot

There are three bond propositions on this ballot:

- ***Proposition 46.*** This measure would authorize the state to sell $2.1 billion of general obligation bonds to fund various housing programs, including those that assist rental housing projects, homeownership, and farmworker housing.
- ***Proposition 47.*** This measure would authorize the state to issue $13.05 billion of general obligation bonds for construction and renovation of K–12 school facilities and higher education facilities.
- ***Proposition 50.*** This measure would authorize the state to sell $3.44 billion of general obligation bonds for various water-related programs. These include coastal protection, the CALFED Bay-Delta program, regional water management, and various safe drinking water programs.